RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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June 30, 1982 **LETTER 838**

June 18, DJIA 788.62; PTI 1304; A-D Ratio –27.29
June 25, DJIA 803.08; PTI 1302; A-D Ratio –27.12

THE PICTURE: QUESTION: What was the meaning of the June 17 market break, which saw the D-J Industrial Average plunge to a new two-year low?

ANSWER: On June 17 the Industrials broke below 795.47, their preceding bear market low set on March 8. By so doing, the Industrials confirmed the violation by the Transports a few days earlier. The joint penetration of the March lows re-confirms the existence of a primary bear market. On the same day (June 17) most of the broader Averages such as the Wilshire 5000, the NYSE Index and the D-J 65 confirmed by breaking their own March lows. On June 18 (just to make it unanimous) the S & P 500 broke its March low.

QUESTION: What does this tell us about the stock market?

ANSWER: As stated in the last Letter, it tells us that the primary trend of the market is down—re-confirmed as down. Remember, however, that as of June 18 the advance-decline ratio (one of the broadest market measurements) was down on 24 out of 28 trading days, an extraordinary string of declines. That long string of daily declines means that we have a lop-sided technical situation at the moment, and I expect the technical situation to be worked off with a rally. Nevertheless, I take the breaking of 795.47 by Industrials as a decidedly BEARISH situation for the longer term; it's a development so negative that I would not (even as a trader) play any rally which may start from this area.

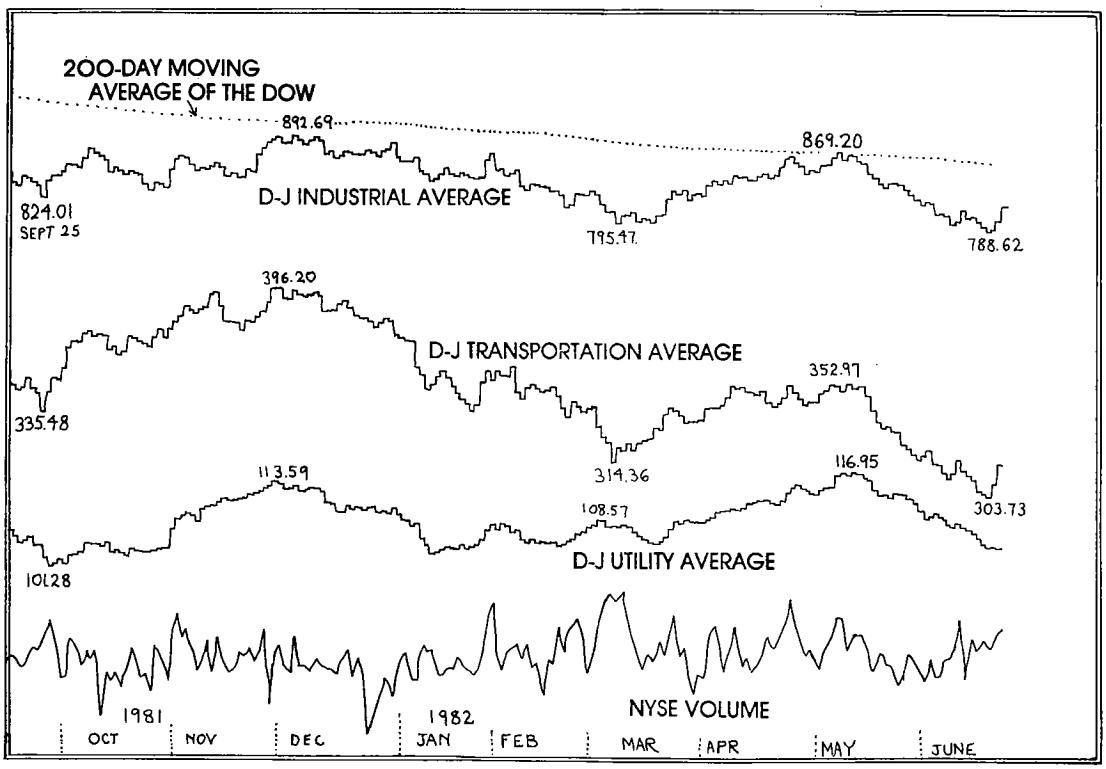
QUESTION: Russell, you've often written about the 4 or 4.5-year cycle. What about that cycle at this time?

FRONT PAGE COMMENT: In an extremely close vote, the House approved a compromise budget that seeks $20 billion in unspecified tax boosts, deep unspecified cuts in social programs, a 7% rise in military spending and a final 1983 deficit of $103 billion.

The "budget" as it now stands is simply a Congressional resolution, a statement of intent by Congress. The specifics have not been decided upon. And judging by the close votes so far, the specifics are going to present problems, major problems. Think about it – the Social Security deficit-mess has been pushed "off budget." Perhaps $20 to $30 billion, in sundry other items have been relegated to "off budget." The final result is nevertheless going to be the largest deficit in the American history. The actual 1983 deficit? Nobody knows yet, but including off-budget it could be above $150 billion.

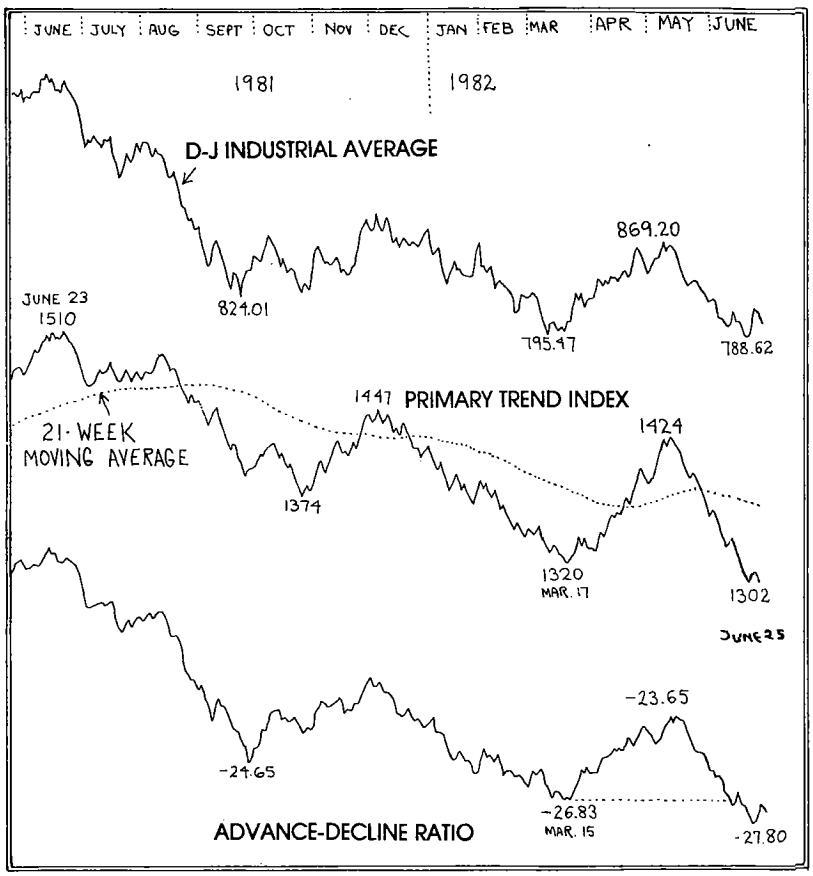
As I've said so many times, the President and Congress haven't even BEGUN to deal with the budget problems. Meanwhile, the money markets staggered as it was announced that the Treasury would sell a whopping $17 billion in securities this week. Even Treasury Secretary Regan (the Administration's perpetual bull) has finally conceded that interest rates may go higher.

ANSWER: There are a few technical items that have become so widely recognized as to render them market cliches. I am afraid that the 4-year cycle may be one. I believe that General Motors may be another. My own feeling is that one or both of these items could be deceptive in the period ahead. The last major low in the four-year cycle occurred during 1974. The 1978 low was not of major cyclical importance and neither was the 1980 low. Whether 1982 (8 years from the 1974 low) will be any better remains to be seen. I'm rather skeptical on this count.



QUESTION: Aside from the market action itself, what about all the sentiment indicators? I mean there seems to be so much bearishness around.

ANSWER: You know that in many recent Letters I warned about the current popularity of the sentiment indicators. Everybody is following them now, and that makes me suspicious. Aside from their popularity, remember that sentiment indicators must be interpreted differently during a primary bear market. When the primary trend is down, the skeptics, the bears, the short sellers, the put buyers, the doubters—they are all on the RIGHT side of the market. Yes, there are times



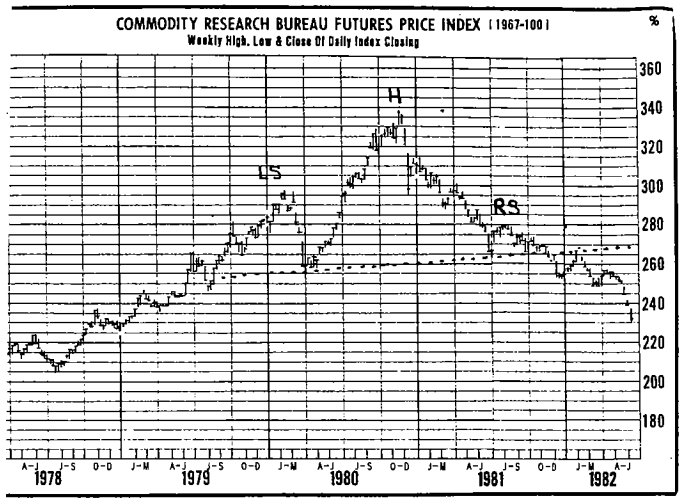
when the pessimists are right and the short sellers are reaping profits; we call those periods bear markets. So don't expect prevailing bearish sentiment to send this market roaring higher. That might happen during a bull market (when the pessimists are aligned against the primary trend) but it will not occur during a bear market.

Another observation is that we are living in very unusual times. Here we have gold and silver and the precious metals breaking down, commodities caving in, the stock market and the bond market in bear trends, collectibles down sharply and housing prices soft. You have to be 70 or older to have seen anything like this before. Therefore, I'm warning subscribers that we're in for some very difficult and trying periods. I've been saying (since 1980) that "Cash will be king." I may have to change that to "Cash will be supreme emperor."

QUESTION: Russell, what do you make of interest rates and the commodities here?

ANSWER: On June 25 my T-bill barometer (see Letter 834, page 2) broke out in favor of higher bill rates. The 13-day moving average of bill rates reversed a 13-month downtrend–to the upside. T-bill momentum had already turned up. This could mean a real push to higher bill and bond yields (the 91-day bills already yield 13% while the T-bonds are back over 14% in yields). Two Letters ago I stated that I thought the bond rally was over. That prediction proved to be correct.

On the economic front the losses have been frightful. On the fateful day of June 17 gold broke to a new low of 309. A few days later (June 21) gold broke below 300. Silver has melted below 5.00 and copper (that barometer of economic activity) has smashed to an incredible $.54. In November, 1980, the



widely-watched CRB Commodity Index of 27 different commodities recorded a bull market high of 337. By last week that Index was down to 231, a whopping 31% off its bull market high. This drop has produced losses in the multi-billions of dollars for both commodity traders and producers. It is also a harbinger of inventory losses and paper losses–yet to be reported. Finally, it is a prediction of deflation.

QUESTION: Are you saying that you see deflation ahead?

ANSWER: With the kind of deflation we've seen in the markets, I would say that it's only a matter of time before the general economy deflates as well. If ticker tapes could make sounds, right now we'd be hearing a noise like air exiting from a large balloon.

QUESTION: Russell, what happened to you in the last Letter? Why did you turn hopeful and indicate that trading for a rally might be in order?

ANSWER: I made a mistake. Or, to be kinder to myself, the market didn't do what I thought it might do. The fact is that the market was even weaker than I had guessed it was.

BUT, there is a good lesson in the last Letter, and every subscriber should understand that lesson. I made certain that there were nearby "exit points" so that any subscriber who traded on the long side would know immediately if he was wrong. One of the exit points was a Dow breaking of the 795.47 level. That level broke the day after Letter 837 was mailed. So the market issued its danger signal *before* any of my readers could buy.

Thus, I may have looked wrong, but it didn't cost any of my readers a cent. And it's the second item that I care most about. After all, it's better to be on the right side of the market with a dummy than it is to be on the wrong side of the market with a genius!

QUESTION: What about the PTI?

ANSWER: The PTI broke to a bear market low of 1302 on June 21, a low that was matched again on June 25.

QUESTION: What do you make of the unbelievable breadth figures? Why has the A-D Ratio registered such a long string of declines?

ANSWER: I always look carefully when the market does the extraordinary. I believe the 24 out of 28 days down was the market's way of telling us that something very serious is coming up in the world of business. I don't yet know what that "something" is, but my bet is that we'll know in a month or so. After all, breadth has literally crashed, and I don't think that would happen in a vacuum. Therefore, I'm saying, be prepared for some very bad news in the third quarter!

QUESTION: Turning to the economy, what do you see for the period ahead?

ANSWER: Well, you know that I take a very dim view of what Congress is doing as far as spending cuts are concerned. The fact is that on both the state and federal level the deficits are coming through in record amounts. Every state and city is short of money and running a deficit. At the same time, there is tremendous resistance to tax increases. It's really an impossible situation.

Politicians like to do the right thing, they want to keep their jobs, and they also want to keep the voters happy. All too often these three desires do not jibe. The politicians are convinced that the voters want the following: government sponsored jobs, freebies and grants, more "helpful" regulations and easy credit.

The problem: how do you provide all these in a nation already strangling in debt? One avenue of hope is still left for the politicians (although, of course, it won't work), and that is to raise taxes on the rich. Therefore, I expect a new assault on the rich (via taxes) now and after the elections.

The depressing fact, however, is that this nation's growth and "prosperity" has been sustained for 40 years by rising debt. If we halt the debt creation, the US will immediately sink into depression. As I see it, the politicians will continue to follow the old patterns (higher taxes, higher spending) until rising interest rates cut off any hope of this nation's ever pulling out of stagflation. Ultimately, and I've said this many times before, the MARKETS WILL CONTROL THE GAME. Already, we see the powerful forces of the market at work, as the Fed and the government appear helpless to bring interest rates down.

Basically, what the politicians have been trying to do ever since World War 11 is sustain prosperity by borrowing from tomorrow–yet never feel the pain of paying back what they borrow. It has been my contention that we are now entering (it started in 1980) the "period of pain."

QUESTION: How long do you think this period of pain could last?

ANSWER: I think we could easily see a decade in which the debt and illiquidity problems weigh heavily on the nation. Remember, it has taken two generations to build the trillion dollar debt monster. That debt is not going to be whittled down to manageable levels in six months or a year.

QUESTION: Do you think we can have bull markets within this period?

ANSWER: Of course we can. For instance, following the 1929-32 crash we had a great bull market, that of 1932-37. At the 1937 high (194 on the Dow) the Dow never bettered its 1929 high. But the percentage rise in the Dow from the 1932 bottom to the 1937 top (and all this occurred during the Great Depression) was an astounding 273%. Thus, even during economic depressions the stock market is perfectly capable of producing huge moves.

QUESTION: Russell, what about the Federal Reserve? They're not going to sit around while the nation slips into depression, are they?

ANSWER: You're damn right, they won't. In fact, the Fed has been pumping away for months. Since the first week in January the adjusted monetary base has been rising at a 9.2% rate. But as I've said so many times, the financial markets have become very sophisticated, and now when the Fed pumps, the financial markets tend to panic (in fear of potential inflation).

On top of this, the huge Federal financing coming up ($90 billion in new money will be needed in the second half, 1982) has frightened bond dealers and bond buyers alike. In the face of this (and despite Fed pumping) interest rates have been rising as bonds approach to within shooting distance of their record lows.

My personal opinion is that Fed Chairman Volcker is aghast at the problems he sees in the economy, and he is also highly disturbed by the economy's failure to respond to the current pumping. I don't think Volcker has any answers at this point–but I do think he's just as afraid of depression now as he is of inflation.

QUESTION: Do you ever worry about the government itself defaulting on its debt?

ANSWER: I must admit that the idea has occurred to me on various occasions. But this is how I reason, and this reasoning is critical. First, we must realize that any government will do WHATEVER IT HAS TO–to perpetuate itself. The US government has been living on a diet of debt and deficits ever since World War 11. The government MUST pay the interest on its debt or it will not be able to issue new debt (and as I said, debt is critical to the government's survival).

So I expect the debt and deficit syndrome to continue–until the period when the money markets cease to function. At that point, the nation will collapse into depression and semi-bankruptcy. That is also the point at which the nation will have to take its medicine.

What is the medicine? The federal budget (either through Congressional will or constitutional law) will have to be brought into balance–in order to revive what's left of the money markets. Then the country will face the Second Great Depression (brought on by massive slashes in federal and state spending). This is the sword that hangs over our heads as we continue on the ridiculous and unsustainable financial path that we are now on.

QUESTION: Russell, as far as the public's attitude is concerned, do you see any changes over the last five to ten years?

ANSWER: Yes, and I think this is important. The public has become fascinated with news and particularly financial news. (see news clip page 4) The Wall Street Journal is now selling two million copies a day; it's the biggest paper in the nation. The public is now quite sophisticated–they want to know. And the news media recognizes this. Now you can turn on your radio or your TV and get news 24 hours a day. You can hear top experts being interviewed, you can hear all sorts of opinions on all phases of economics.

New York

It's the old law of supply and demand.

In this time of recession, American consumers are "demanding" to know how they can stay one step ahead in their finances. Individual retirement accounts (IRAs), money market funds, stocks, and the state of the economy in general are hot topics – even among beginning investors.

And who has stepped up to "supply" the information? The media – including radio.

In the past 18 months, CBS, NBC, and ABC have sent out new, brief financial programming on the radio waves. The networks have been joined by an entrepreneur from upstate New York, and a number of independent stations that have set up their own money bureaus.

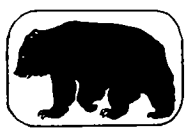
So whereas Lyndon Johnson could under-finance a Vietnam War and never tell the public what he was doing, today that would be impossible. The public knows about deficits, it knows about the Fed, it knows about interest rates, and it has increasingly less respect for the way Congress and the Treasury are handling the financial affairs of this nation.

Through my occasional speeches, I can tell that the American public has grown very pessimistic about debt and deficits, and people know that we are on the wrong path. But there's a tremendous inertia that has enveloped this nation, and the inertia dictates sticking to the old path, the path of debt. That path, while it hyped the economy for years, is now leading this nation to the edge of the cliff.

QUESTION: Russell, do you think the government can turn this recession around?

ANSWER: The primary trend is more powerful than Congress, the President and the US Treasury combined. Government can spur a boom, but it can't stop a bear market. This bear market is going to conclusion, and the best the government can do (assuming they choose to do so) is to extend the situation–push the ultimate bottom further away. But we also have to remember that the longer the conclusion is held off, the worse it will be. In fact, it's the government's perpetual manipulation and interfering with natural forces that has placed this nation in such dire straits. The bear will have his way, and wise men don't try to force the bottom or predict the bottom. The wise man simply tries to identify the bottom when it arrives.

INVESTMENT POSITION: With the March lows in the Averages shattered, I've put the grizzly back in the box (he had a very short rest). It's my feeling that the second phase of this bear market is near ending, and the third phase lies directly ahead. The third phase is the distress phase. During the third phase, those who have been saving for a rainy day–wake up to find that it is raining.



REFLECTIONS: A while back, T. Boone Pickens and his wife flew up to La Jolla from Texas, and my wife, Paula, and I had dinner with them. It was a good dinner, and we had a most enjoyable time. Last week I read where Boone has just made a quick $40 million for himself and his company, Mesa Petroleum, on the Cities Service buyout. Well, Boone Pickens is Texas-rich, and he's far out of my class. But in one area, I'll match myself with the Mesa Chairman. That area is peace of mind.

I've got peace of mind. And I sincerely hope all of my subscribers do too.I don't care how many millions you have, I don't care if you have condos in ten different cities, I don't care if a dozen secretaries come running every time you push the first button on your desk top, none of it means a thing if you don't have peace of mind.

A New York.friend once told me that a tycoon he knew "couldn't sleep unless he owed at least $20 million at any given time." If that's what gives him contentment, welcome to it. What gives me peace of mind is not owing anyone a cent, feeling OK about myself, and not waking up in a sweat over whether my last deal or my last trade is going to send me to the poor house.

There's a story about a young banker who happened to belong to the same club that J.P. Morgan belonged to. One day as Morgan entered, the young fellow walked up to him and said, "Congratulate me, Mr. Morgan, I've just made my first million and now I'm going to retire." Morgan shook his head, "That's too bad," he said, "now you'll never know what it feels like to be rich."

So I guess everything is relative. But peace of mind isn't relative, and the young banker (for all we know) may have been more at peace with himself and the world than Morgan was.

As for me, I go my own way, I do what I'm able for my family, my friends and the world, and I feel pretty much at peace. Large speculative positions don't fascinate me now, the way they did 15 or 20 years ago. In fact, they worry me, so I tend to be kind of conservative as far as the markets are concerned.

I know that some analysts state that the market is always either a short or a long. Maybe so, but there are times when it can also be killer, a prelude to sleepless nights. One thing I love about the market is that it is always there–but I don't always have to be in it. Meanwhile, the T-bills yields are heading up, and I feel fine about collecting a safe 13%. And I'm hoping we get a historic market bottom sometime in the next two to a dozen months.

NOTES & QUOTES: Which came first, the chicken or the egg? Which came first, the horrendous debt position of the less developed nations or the bankers who were so frenzied to lend them money? It doesn't matter too much now, the eggs and the banks are already in the frying pan. Here are a few excerpts from the International Bank Credit Analyst about our neighbor to the South (and, by the way, just 20 miles south of where these Letters are written):

"One oil producer which is already in deep financial and economic difficulty is Mexico. Last year the external debt of the public sector in Mexico increased a staggering $18 billion to $51.7 billion, and the combined external debt of both the public and private sectors reached $72 billion. That heads the world in unrepayable debt. Gross borrowing needs of the government for 1982 are now estimated at between $25 and $28 billion . . . . It hardly needs to be said that these numbers are out of all proportion, and it 's difficult to conceive how such huge debts can ever be repaid. The economy is stagnating and inflation is up at 60% . . . . . Mexico is in very great trouble. The country is rapidly creating the conditions for hyperinflation or severe depression or both."

* *

If there was no Fed, the politicians would have to invent one. After all, when our Washington representatives spend their fool heads off and interest rates (in reaction) stay high, who are they going to blame? Why the Fed, of course (not that the Fed isn't prone to pump away when the pressure is on). At any rate, this cartoonist makes a cogent point (and no, the strip was not authored by Volcker):

CONGRESSMAN, EH?... SO YOU'RE THE CLOWN WHO'S BEEN FLUSHIN' MY TAX BUCKS DOWN THE TUBES!!
I SEE YOU VOTED FOR ANOTHER FAT PAY RAISE FOR YOURSELF...
WELL, WELL!... IS IT ELECTION TIME AGAIN? I GUESS YOU WANNA RAISE MY TAXES AGAIN, TOO...
I HEAR YOU LIZARDS VOTED A SWEET TAX BREAK FOR YERSELVES!!
GOT ANY GOOD PROGRAMS OR TAX LOOPHOLES FOR US WORKING STIFFS?
My constituents tell me they are deeply concerned about the deficit and the tight money policy of the Federal Reserve...
MACNELLY Chicago Tribune

* *

The following rundown (from the San Diego Union) pertains to a recent Wharton Magazine Article. I thought it well worth including.

PHILADELPHIA (AP) — The mounting debt for oil purchases in many nations, coupled with U.S. trade deficits, could lead to a collapse of the world economy in the coming decade, according to a study published here.

Such a collapse could result in restructuring the world's economy, with regional trading relationships springing up to replace today's global marketplace, according to the study in the spring issue of the Wharton Magazine.

"As oil import bills grow, international debt burdens grow and the financial system becomes more unstable," authors Richard Drobnick and Selwyn Enzer wrote in the magazine, which is published by the University of Pennsylvania's Wharton School.

Developing countries owed an estimated $530 billion in 1981, much of that for imported oil and most of it "unrepayable," according to the authors, who work for the Twenty Year Forecast Project at the University of Southern California's Center for Futures Research.

In addition, the authors say, "The United States has contributed to the unstable state of international financial affairs by dramatically expanding the international money supply" and running up a cumulative trade deficit in the 1970s of about $140 billion.

"This 'easy money' policy . . . promoted the international inflationary spiral and permitted the debt buildup that presently threatens the viability of the international financial system," the article says.

The authors contend that neither Arab nations nor the world's lending institutions can continuously advance large financial credits to oil importers.

"Such an untenable situation is likely to lead to cancellation or repudiation of debts, reduced sales of Arabian petroleum, or, possibly, military conflict," the study says.

If financial instability leads to economic collapse, the authors say it could spell the end of global trading patterns and give rise to regional trade relationships between manufacturing countries and neighbors rich in oil or natural resources.

Natural trade partners would be the United States, Mexico and Canada; China and Japan; Western Europe and African or Arab states; and the Soviet Union, Eastern Europe and Arab countries, the study says.

Other possible consequences include a collapse of OPEC, principally due to the increased energy independence of the United States; increased OPEC investment in underdeveloped nations to reduce the mounting oil debt, or possible military intervention in the oil-producing nations by industrial powers to establish international control of oil fields, the study says.

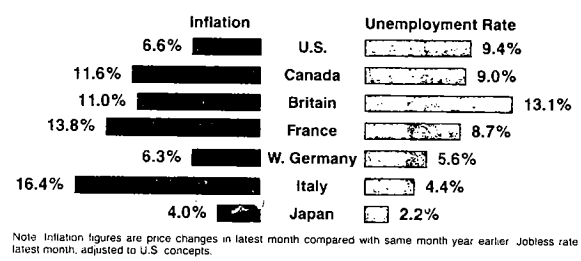
* *

The latest issue of Dun's Magazine carried an article entitled, "The Crash in Collectibles." The article dealt with the smash in many items that boomed during the late 1970s and right up to 1981. The hardest hit markets were those that drew the biggest influx of "inflation-oriented" investors, items such as diamonds, photographs, and furniture. Also hard hit were "middle market" items and secondary or inferior works by artists. Here are some figures from Salomon Bros. covering percentage changes in the last year for various items: US coins down 27.8%; US stamps down 3%, oriental rugs down 16.2%, gold down 34%, old master paintings down 22%, stocks down 10.5%.

The diamond industry is chaotic. Once a monopoly, the DeBeers group is now facing competition from Zaire and Australia. DeBeers has cut back its diamond production 60% and it is spending millions buying up diamonds in an effort to "support" the market. The DeBeers inventory of diamonds has now swelled to over a billion dollars. And DeBeers (for the first time in 37 years) has cut its dividend. Meanwhile, the price of diamonds has collapsed, and gem grade stones are down as much as 50 to 60%. I view the whole thing as just another facet of deflation.

* *

Remember when the "Discomfort Index" (the inflation rate plus the unemployment rate) was up to 10%? That was considered a high degree of discomfort. Here are *US News & World Report's* figures on the two items. US discomfort rate now 16%, Canada 20.6%, Britain 24.1%, France 22.2%, Germany 11.9%, Italy 20.8%, Japan 6.2%.



Note: Inflation figures are price changes in latest month compared with same month year earlier. Jobless rate is latest month, adjusted to U.S. concepts.

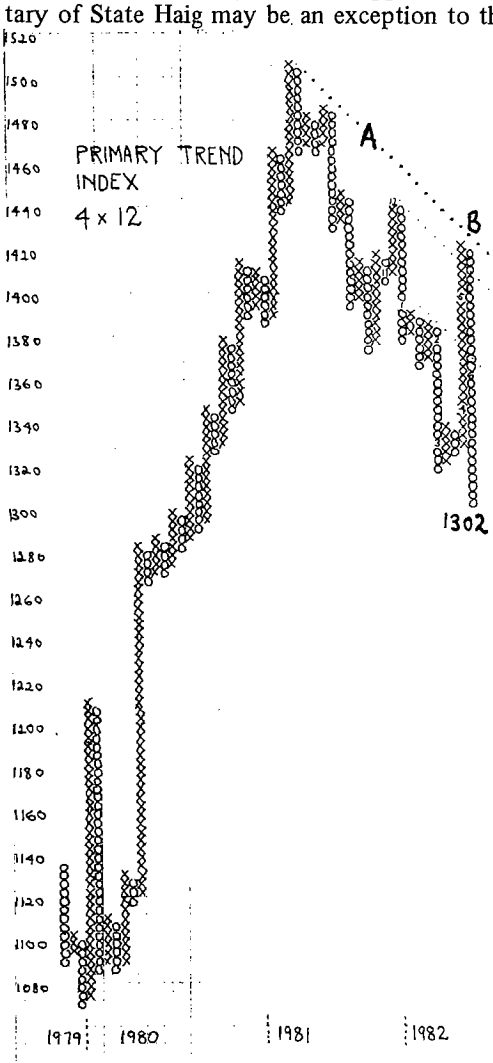
SPECIAL STUDY, PTI: This is a 4 x 12 chart of the PTI; each square equals 4 points and only rallies or declines of 12 points or more are shown. Note that all the action has taken place *below* major trendline A. Following the spike to point B, the PTI plunged below its March low of 1315–to a new low of 1302 on June 25,

With the new low at 1302, the spike to point B has turned into what I term a "tail pattern" and as a rule such patterns constitute a technical trap. While the PTI could rally back and perhaps push into the 310-320 area again, I would consider any rally in the PTI from here to be simply a bounce following the 122 point smash from the 1424 peak at point B to the current 1302 low.

With the PTI closing at its low of 1302 on Friday, June 25, any further weakness in the market this week will carry the PTI to new bear market lows. Successive lows in the PTI carry bearish connotations.

LATE NOTES: The market often gives hints of a reversal in trend through the breadth statistics. For instance, three consecutive days in which advances on the NYSE number 1000 or more usually signals an important rally. But no such signal has appeared in many months. On the contrary, the market continues to issue warnings of weakness. On June 25, the negative volume index broke to a new bear market low, and this tells us that the smart money is still moving towards the exits.

One of the characteristics of a primary bear market is that whatever rotten can happen–does happen. The departure of Secretary of State Haig may be an exception to this rule. Haig, a man of unlimited ambition and limited intelligence, has been a thorn in the side of the Reagan Administration from the beginning. If Haig runs true to form, he'll try for President in 1984.



GOLD: Can mathematics kill you? It can if you are a currency (like the dollar) and you continue to build up more debt than the issuing country (the US) can handle. After all, only gold is real money. The dollar is a "managed currency" and any managed currency can die of mismanagement.

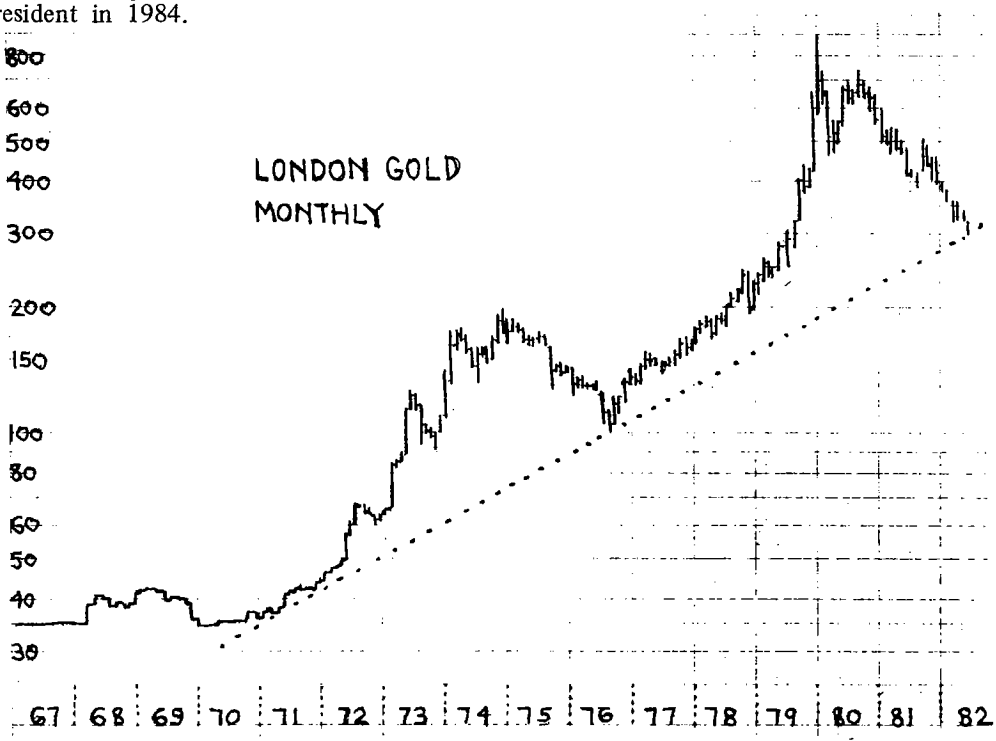
To my mind, the greatest argument for holding any gold today is US mismanagement of the currency. No matter what your local Congressmen tells you, the US budget is still totally OUT OF CONTROL. And that, in my opinion, is why gold has held up so much better than silver, platinum, soy beans or lumber.

Many years ago in Esquire I saw a cartoon showing two well-heeled Southerners sitting in their lounge chairs in a plush Mississippi country club. One says to the other, "I sent $1000 to the NAACP just in case." And that's the reason why many wealthy people continue to hold at least "survival positions" in gold. They hold their gold coins (and I'm one of them)–just in case.

This monthly chart shows gold's entire move from the 35 level back in the early '70s to date. Note that the major (primary) trendline comes in at about 300. Which is just about where gold is supporting today. I'll be very interested to see whether gold holds roughly above 300–or whether the back of the whole gold bull market is broken (to be signalled by a gold plunge below 300).

Either way, I'll hold my little pile of gold coins. Why? Oh, just in case!

The study of the three moving averages (MAs) for gold has kept us out of trouble for a long time. The study is still keeping us out of trouble. The long-term or 50-week MA now stands at 382. The intermediate or 13-week MA stands at 329. The short-term or 5-week MA is at 314. All three MA's are still moving down, and gold for spot delivery is still below the 5-week MA. The first encouraging sign on the MA study would be a move on the London fix above 314.



NEXT MAILING: July 14